



Patent
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on
3/6/03

IN THE UNITED STATES PATENT AND TRADEMARK OFFICE

Applicant : T. PACKWOOD
Serial No. : 09/544,400
Filing Date : April 6, 2000
For : RISK ASSESSMENT AND MANAGEMENT SYSTEM
Examiner : G. Akers
Group Art Unit : 3624

Commissioner for Patents
Washington, D.C. 20231

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DECLARATION OF PRIOR INVENTION PURSUANT TO 37 C.F.R. §1.131

I, Thomas R. Packwood, the sole inventor of the above-captioned patent application do hereby declare:

1. This declaration is submitted to establish a date of invention prior to August 31, 1998, which is the effective date of U.S. Patent 6,223,143 to Weinstock cited by the examiner;

2. I am an employee of Union State Bank, Orangeburg, New York, the assignee of the application, and I created this invention during the course of my employment while in Orangeburg, New York;

3. In 1998, I began formulating and conceptualizing a method for more effectively evaluating and managing risks associated with the business of Union State Bank;

4. On August 10, 1998, I prepared and sent a memorandum describing my inventive method for evaluating and managing risks to my superiors at Union State Bank. A redacted copy of my memorandum and representative portions of Appendices A and B to my memorandum are attached hereto as Exhibit 1. The redacted portions include identifications of particular employees and sensitive or confidential business information relating to particular operations of Union State Bank, and are not essential to an understanding of the invention described therein. Particularly, the actual values for the risk factors and ranges in the enclosed portion of Appendix A have been redacted;

5. My memorandum describes and illustrates substantially all aspects of my invention, including identifying risk factors, developing at least two ranges of risk levels for each risk factor, determining and coding the actual risk level value for each risk factor by a color coded indicia, assigning risk tolerance levels to the risk factors, preparing a report of the risk factors, and using a computer to prepare the report; and

6. I hereby declare that all statements made herein of my own knowledge are true and that all statements made on information and belief are believed to be true; and further, that these statements were made with the knowledge that willful false statements and the like so made are punishable by fine or imprisonment, or both, under 18 U.S.C. §1001, and that such willful false statements may jeopardize the validity of this application or any patent issued thereon.

Dated: 3/6/03

By: Thomas R. Packwood
Thomas R. Packwood

71 K. copy

UNION STATE BANK
Inter-Office Memorandum

To: Thomas E. Hales, Chief Executive Officer
Steven ~~S~~. Sabatini, Chief Financial Officer

From: Thomas R. Packwood, Chief Internal Auditor

Thomas R. Packwood

Date: August 10, 1998

Subject: Risk Management

Proper Risk Management is critical to the success of an organization. A while back, I was tasked with investigating and developing a centralized risk management system. Although our present risk management systems were effective (senior management and Board review), it was deemed prudent to enhance and centralize our risk management system. The centralizing of our risk management system is also in direct correlation with the core covenant, in that standards for measuring risk tolerance will be established and clearly documented. In the rest of this document, I will outline my proposal for centralized risk management.

Each area of the Bank, [REDACTED] level, presently is responsible for managing the risk in his/her respective area. My proposal to centralize the risk management systems will not change this. Two key documents have been created to review, document and monitor risk. Appendix A is the quarterly risk monitoring report. Each department of the Bank will have a report (Branch Administration, Compliance, Finance, Internal Audit, Loans, Marketing, Operations Division, Personnel). This Appendix A is a first draft document, the risks and risk standards will have to be reviewed with the respective department manager. I accumulated this information from my knowledge and experience with the Bank, the key goal of this memo to you today is to agree with the concept and framework of this quarterly risk management report. The more people who review and comment on this document (USB management committee, [REDACTED], examiners), the better. The most time consuming part of this project [REDACTED] will be the initial detailed review required to establish the Bank's risk standards. Many of these standards should come from existing Board policies. Once the initial risk standards are established, only ongoing maintenance of the Bank's risk standards will be required.

Note: The [REDACTED] risk numbers utilized in this first draft of the quarterly risk monitoring are estimated for presentation purposes. Again, the purpose of this first draft is to agree with the conceptual framework of this report. The risk numbers will be verified during future drafts. It is also assumed that the departments will add additional risk measures to this report during their review.

The quarterly risk management report adopted the red, yellow, green light approach. Red is defined as "Significantly below Bank standards. Corrective Action necessary". Yellow is defined as "Acceptable, but below Bank standards. Proactive, early action necessary". Green is defined as "In compliance with

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U N I T A R Y S T A T E B A N K
Inter-Office Memorandum

Bank standards". Appendix B is the risk matrix for each department of the Bank. This matrix documents the annual risk analysis for each department of the Bank. Each year when the risk matrix is completed (August 31) it would be compared to the quarterly risk management report to make sure all measurable risks are adequately addressed in the quarterly risk management report.

A question/answer format will be utilized to explain this process further.

Who will prepare the quarterly risk management report? Each department will be responsible for answering/calculating their risk information and then will forward the information to the Internal Audit Department (As an alternative, this might be a Chairman's Department L. Brown report?). This process will function in a similar fashion to our current monthly Proving & Aging report process. The risk information would be entered into the computer and the centralized risk management report would be generated. [REDACTED] would get full copies of this report. All other [REDACTED] members would only get copies of the risk management report pertaining to their respective area. A full copy of this quarterly risk management report would then be reviewed with the Board of Directors at the next Board meeting.

How will the integrity of the risk information submitted by the departments be maintained? The preparer of the departmental risk information will be expected to maintain a file of supporting workpapers. A supervisor of the respective department will be expected to approve the risk information before it is submitted to Internal Audit. These workpapers must be retained by the respective department, and they will be reviewed as part of the next Internal Audit review of the respective area.

How will the risk standards be changed? Since the risk standards are controlled centrally [REDACTED], an approval [REDACTED] will be required to change the risk standards. It is concluded therefore that the risk managers will communicate/discuss risk standard changes [REDACTED].

Will we have a one page centralized risk management report? Yes. After the departmental risk management reports are finalized, they will be reviewed and the key information from these reports will be consolidated into a one page report.

Are there future plans to enhance the quarterly risk management report? Yes. For some of the larger departments of the Bank, Finance, Operations, and Loans, it might become necessary to segregate the risk management report by the operating units within the Department (for example* Finance- Accounting, Investments, Asset/Liability, Purchasing).

I would like to meet with you to discuss this memo as soon as possible. If possible, I would like to present this centralized risk management process at the August 21, 1998 Management Committee meeting. With the approval of this memo, I would then meet with department heads individually to review both of these documents and then prepare revised copies of both these documents. The

UNION STATE BANK
Inter-Office Memorandum

end result would be that this would serve as the centralized risk management documentation for 1998/1999. I would like to have the 1998 risk matrix (Appendix B) completed by August 31, 1998. I would like to have the first quarterly risk management report issued as of September 30, 1998. I will actively work with the departments, but it is key that the departments realize that this is their risk monitoring/supervisory report, it is not an Internal Audit report. I will need your help in emphasizing this to all Management Committee members.

(A)

Union State Bank

Risk Management Report

Branch Administration Department

Date: March 31, 1998

Risk Manager: [REDACTED]

Red	Significantly below Bank standards. Corrective action necessary.
Yellow	Acceptable, but below Bank standards. Proactive, early action necessary.
Green	In compliance with Bank standards.

1. Last compliance regulatory exam rating.	20.	39.
2. Bankwide efficiency ratio. [REDACTED] %	21.	40.
3. Last Safety and Soundness exam rating.	22.	41.
4. Net interest income as a % of average assets. [REDACTED] %	23.	42.
5. Tellers over & shorts for the quarter. [REDACTED]	24.	43.
6. Branch charge-offs for the quarter. [REDACTED]	25.	44.
7. Last Internal Audit Report Rating.	26.	45.
8. # of employee warnings filed this quarter.	27.	46.
Months since last Board approval of Branching Policy.	28.	47.
10. # of unprofitable branches in the branch system.	29.	48.
11. Average overdraft and uncollected charge % for the quarter. [REDACTED] %	30.	49.
12. Self Assessment of Year 2000 compliance. [REDACTED] %	31.	50.
13.	32.	51.
14.	33.	52.
15.	34.	53.
16.	35.	54.
17.	36.	55.
18.	37.	56.
	38.	57.

Union State Bank

Risk Management Report

Branch Administration Department

Date: March 31, 1998

Risk Manager: [REDACTED]

Red Significantly below Bank Standards. Corrective action necessary.

Yellow Acceptable, but below Bank standards. Proactive, early action necessary.

Green In compliance with Bank standards.

Legend for Risk Management Reporting:

- | | |
|---|---|
| <p>1. Last Compliance Regulatory exam rating:
Red ~ 3 or more
Yellow ~ 2 through 3
Green ~ 0</p> <p>2. Bankwide efficiency ratio:
Red ~ 1% or more
Yellow ~ 1% through 2%
Green ~ 1% or less</p> <p>3. Last Safety and Soundness Exam rating:
Red ~ CAMELS 3 or 4
Yellow ~ CAMELS 2
Green ~ CAMELS 1 or 2</p> <p>4. Net interest income as a % of average assets:
Red ~ 1% or less
Yellow ~ 1% through 2%
Green ~ 2% or more</p> <p>5. Tellers over & shorts for the quarter:
Red ~ \$1000 or more
Yellow ~ \$500 through \$1000
Green ~ \$500 or less</p> <p>6. Branch charge-offs for the quarter:
Red ~ \$1000 or more
Yellow ~ \$500 through \$1000
Green ~ \$500 or less</p> <p>7. Last Internal Audit Report Rating:
Red ~ Level 3 or below
Yellow ~ Level 2
Green ~ Level 1 or Level 2</p> <p>8. # of employee warnings filed this quarter:
Red ~ 3 or more
Yellow ~ 1 through 3
Green ~ 1 or less</p> <p>9. Last Board approval of Branching Policy:
Red ~ 12 months or more
Yellow ~ 6 through 12 months
Green ~ 6 months or less</p> <p>10. # of unprofitable branches in the branch system:
Red ~ 3 or more
Yellow ~ 1 through 3
Green ~ 1 or less</p> <p>11. Average overdraft and uncollected charges for the quarter:
Red ~ 1% or less
Yellow ~ 1% through 2%
Green ~ 2% or more</p> <p>12. Self Assessment of the Year 2000 compliance:
Red ~ 1% or less
Yellow ~ 1% through 2%
Green ~ 2% or more</p> <p>13.
Red ~
Yellow ~
Green ~</p> | <p>14.
Red ~
Yellow ~
Green ~</p> <p>15.
Red ~
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Green ~</p> <p>16.
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|---|---|

Union State Bank

Risk Management Report

Compliance Department

Date: March 31, 1998

Risk Manager: [REDACTED]

Red

Significantly below Bank standards. Corrective action necessary.

Yellow

Acceptable, but below Bank standards. Proactive, early action necessary.

Green

In compliance with Bank standards.

1. Last Compliance Regulatory Exam rating		20.	39.
2. Bankwide efficiency ratio.	%	21.	40.
3. Last Safety and Soundness exam rating		22.	41.
4. Last CRA rating. (1)Outstanding, (2)Satisfactory, (3)Needs to Improve, (4)Substantial Non-compliance.		23.	42.
5. Last Internal Audit Report Rating		24.	43.
6. Months since last Board approval of the Compliance Program.		25.	44.
7. Months since last Board approval of Bank Secrecy Act Policy.		26.	45.
8. Months since last Board approval of the Office of Foreign Assets Control Policy.		27.	46.
9. # of Compliance Program areas not reviewed within the last 24 months. (16 total review areas)		28.	47.
10. Self Assessment of Year 2000 compliance.	%	29.	48.
11.		30.	49.
12.		31.	50.
13.		32.	51.
14.		33.	52.
15.		34.	53.
16.		35.	54.
17.		36.	55.
		37.	56.
19.		38.	57.

Union State Bank

Risk Management Report

Compliance Department

Date: March 31, 1998

Risk Manager: [REDACTED]

Red	Significantly below Bank Standards. Corrective action necessary.
Yellow	Acceptable, but below Bank standards. Proactive, early action necessary.
Green	In compliance with Bank standards.

Legend for Risk Management Reporting:

1. Last Compliance Regulatory rating:

Red ~ [REDACTED]
Yellow ~ [REDACTED]
Green ~ [REDACTED]

2. Bankwide efficiency ratio:

Red ~ [REDACTED]% or more
Yellow ~ [REDACTED]% through [REDACTED]%
Green ~ [REDACTED]% or less

3. Last Safety and Soundness Exam rating:

Red ~ CAMELS [REDACTED]
Yellow ~ CAMELS [REDACTED]
Green ~ CAMELS [REDACTED]

4. Last CRA rating:

Red ~ Substantial Noncompliance
Yellow ~ Needs to Improve
Green ~ Outstanding or Satisfactory

5. Last Internal Audit Report Rating:

Red ~ Level [REDACTED] or below
Yellow ~ Level [REDACTED]
Green ~ Level [REDACTED] or Level [REDACTED]

6. Months since last Board approval of the Compliance Program:

Red ~ [REDACTED] months or more
Yellow ~ [REDACTED] through [REDACTED] months
Green ~ [REDACTED] months or less

7. Months since last Board approval of Bank Secrecy Act Policy:

Red ~ [REDACTED] months or more
Yellow ~ [REDACTED] through [REDACTED] months
Green ~ [REDACTED] months or less

8. Months since last Board approval of the Foreign Assets Control Policy:

Red ~ [REDACTED] months or more
Yellow ~ [REDACTED] through [REDACTED] months
Green ~ [REDACTED] months or less

9. # of Compliance areas not reviewed within the last 24 months:

Red ~ [REDACTED] or more
Yellow ~ [REDACTED] through [REDACTED]
Green ~ [REDACTED]

10. Self Assessment of year 2000 compliance:

Red ~ Less than [REDACTED]%
Yellow ~ Between [REDACTED]% and [REDACTED]%
Green ~ [REDACTED]% or more

11.

Red ~
Yellow ~
Green ~

12.

Red ~
Yellow ~
Green ~

13.

Red ~
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Yellow ~
Green ~

RISK	RISK LEVEL	RISK TOLERANCE	RISK IMPLICATIONS	MONITORING/REPORTING	CONTROLS	RECOMMENDATIONS
<p>Competency/Reliability Risk The risk that the regulators and independent accountants conclude that the Internal Audit/Loan Review Department is unreliable</p>	Low	Low	<ul style="list-style-type: none"> - regulatory orders - increased auditing fees - micro-management 	<ul style="list-style-type: none"> - Quarterly audit activity summary report - Annual independent accountant audits - Annual regulatory examinations 	<ul style="list-style-type: none"> - Employee performance evaluations - Submission of annual audit plans and yearly audit conclusions' memo to the Examining Committee - Quarterly audit activity summary report to the Board of Directors 	<ul style="list-style-type: none"> - Quarterly Examining Committee meetings - formal, documented assessment of audit by the Board (SAS 65)
<p>Detection Risk This is the risk of failing to identify material misstatements of the financial statements' fraud, irregularities, illegal acts, violations of laws, problem loans, material weaknesses in controls and reportable conditions</p>	Moderate	Low	<ul style="list-style-type: none"> - increased losses due to not uncovering frauds - reporting of material weaknesses to the FDIC by independent accountants if not identified and corrective measures implemented - increased losses due to not identifying problem loans on a timely basis - fines for violations of laws 	<ul style="list-style-type: none"> - A comprehensive, cost-effective and risk-based audit plan approved by the Board of Directors - Quarterly summary of audit activities to the Board of Directors - Quarterly allowance memo 	<ul style="list-style-type: none"> - proper instruction of audits and adequate supervisory review - A well-trained and knowledgeable staff (seminars) - Identification of problem loans, quarterly loans over \$100K report from loan officers - Annual internal audits of various departments 	<ul style="list-style-type: none"> - Develop, enhance the audits of the Finance Department. Design a system that is risk based, timely and acceptable to the regulators and independent auditors
<p>Personnel Risk The risk that existing employees of the department will leave/retire without adequate documentation of the procedures performed. The risk is that certain procedures might be omitted or that there is an inordinate amount of transition time for new employees in the Department.</p>	Moderate	Low	<ul style="list-style-type: none"> - An Audit Department must be able to react to risk in a timely and efficient manner and perform audits as frequently as risk analysis requires. Failure to complete audits and failure to react to issues on a timely basis could lead to increased losses. 	<ul style="list-style-type: none"> - review of audit operating procedures by Chief Internal Auditor 	<ul style="list-style-type: none"> - written job descriptions - Audit programs 	<ul style="list-style-type: none"> - assign, communicate and set target date for critical procedures to be documented

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(B)